STATE OF MAINE
PUBLIC UTILITIES COMMISSION

April 29, 2003

ORDER

BANGOR GAS COMPANY, LLC
Request for Approval of Affiliated Interest Transaction with Sempra Energy Trading Company (§ 707)

Docket No. 2002-611

BANGOR GAS COMPANY, LLC
Proposed Cost of Gas Adjustment (§ 4703)

Docket No. 2003-111

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. SUMMARY

We approve Bangor Gas Company LLC's (Bangor Gas) Cost of Gas Adjustment (CGA) for the 2003 summer period as updated in its April 15, 2003 filing. In addition, we approve Bangor Gas's April 10, 2003 request for an extension of its affiliated interest contract with Sempra Energy Trading Corporation (SET) to supply Bangor Gas's gas supply needs for the 2003 summer period.

II. PROCEDURAL HISTORY

On February 18, 2003, Bangor Gas filed its proposed cost of gas adjustment for the 2003 summer period. The Commission issued a Notice of Proceeding to intervenors in prior CGA cases and by publication in newspapers of general circulation in Bangor Gas's service area. The Office of the Public Advocate filed a timely petition to intervene, which was subsequently granted by the Hearing Examiner.

On April 9, 2003, the Hearing Examiner issued Temporary Protective Order No. 1 protecting Gas Supply Bid, Usage, Facilities, Marketing and Customer Information.

On March 24, 2003, Bangor Gas filed a proposal to collect a portion of the under-collection from the Winter 2002-2003 period in the summer period. It proposed to collect the under-collection over a 24-month period by adding a surcharge to the rates of all customers.

A combined preliminary hearing and technical conference was held on April 1, 2003 at which the Hearing Examiner addressed interventions and set a procedural schedule. In addition, the Company reported on the results of its bid process, and the

Advisory Staff and OPA explored the issues raised by this filing. An additional technical conference was held by phone on April 8, 2003 to further discuss the issues.

On April 10, 2003, Bangor Gas filed a request in this docket to approve an amended contract[1] with its affiliate, SET, to supply Bangor Gas's gas supply needs for the 2003 summer period. Bangor Gas stated that it issued a Request for Proposal to a number of potential shippers and selected its affiliate SET from the responsive bids.

On April 15, 2003, the Company made an updated filing that reflected the April 11, 2003 settlement prices for natural gas futures on the NYMEX market.

III. DESCRIPTION OF BANGOR GAS'S PROPOSED RATE

In this filing, Bangor Gas seeks to establish an estimated cost of gas rate to apply to all customers who take service in the upcoming summer period. Bangor Gas is a start-up gas distribution utility whose gas supply requirements may change daily as customers are added. Bangor Gas does not plan to manage the gas procurement function in-house at this time, consistent with its proposal in all previous CGA periods.

Because its actual gas requirements for the upcoming summer period cannot be forecast with confidence, Bangor Gas plans to contract with a supplier to provide gas at market prices throughout the summer period as those needs arise, similar to the contract entered into in several past gas periods. Bangor Gas asserts that the current natural gas futures prices are the best indicators of market prices and, thus, its expected gas costs for the upcoming summer period, and it proposes to set a rate based on those futures.

In its initial filing, Bangor Gas filed its schedule for obtaining bids and selecting its gas provider for the summer period. At the April 1, 2003 technical conference, Bangor Gas witnesses Joseph D. Cote and Heidi J. Harnish testified that the Company selected Bangor Gas's affiliate, Sempra Energy Trading Company (SET) to provide gas supply during the summer months. Bangor Gas and SET have amended the existing contract for the 2002-2003 winter period to reflect the new terms of supply service. These terms include price, which is confidential, and an extension of the term of the agreement through the summer 2003 period.

In its testimony, Bangor Gas outlined the components of a "normal" Cost of Gas Adjustment, such as storage, injection or withdrawal capacity charges, balancing fees or charges, and carrying costs on gas in storage, consistent with its filed tariff in Docket No. 99-531. However, the rate proposed by Bangor Gas does not reflect many of these components because it does not incur such costs under its supply arrangement with

[1] Bangor Gas will file an executed copy of the contract amendment upon receipt of Commission approval of the contract. It has verified that the terms and conditions will be identical to those included in SET's offer to provide service.

SET. Bangor Gas included a sales forecast for the summer period in its filing but that forecast is dependent on when, and if, it obtains the estimated new customers.

Using a methodology intended to produce a proxy for market price, Bangor Gas's proposed 2003 summer CGA would increase the energy charge for all classes of customers from the current tariff rate of $0.541 per therm for the Winter 2002-2003 period to $0.579 per therm. The new rate is based on projected costs of natural gas in the region based upon an average of futures prices, as reported in the Wall Street Journal on April 14, 2003 for the April 11, 2003 settlement prices, adjusted for additional costs to transport gas supplies to New England. The proposed rate also includes Bangor Gas's reservation charge paid to Maritimes & Northeast Pipeline (MNE) for capacity on the Veazie lateral and the MNE Veazie Lateral ACA Surcharge.[2]

Additionally, Bangor Gas's rates now include a past gas cost adjustment of $0.014 per therm to reconcile under-collections during the 2002 summer period, as compared to the past gas cost reconciliation rate of $0.077 included in the winter 2002-2003 period rate.

Bangor Gas also proposed to include a surcharge of $0.047 in its 2003 summer period rates to recover a portion of the Winter 2002-2003 under-collection. This rate was calculated to allow Bangor Gas to recover the under-collection over a 24-month period from all of its customers. However, after further discussion among the parties as outlined below, Bangor Gas agreed that the no portion of the under-collection would be collected during the summer 2003 period.

IV. ANALYSIS

1. Summer CGA Rate

Bangor Gas proposes that we set the CGA rate based on the natural gas futures prices as settled on April 11, 2003 and reported in the Wall Street Journal on April 14, 2003 plus an adder representing transport costs. This adder was calculated as the difference between the Tennessee Zone 6 and NYMEX prices for the summer of 2002.[3] Bangor Gas states that this price is a proxy for the forecast commodity price that would be delivered into Bangor Gas's system and is consistent with the terms of its amended contract with SET.

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[2] The ACA surcharge is an annual charge that FERC bills to all companies it regulates to cover the agency's operational costs. This charge is then flowed through to the end-users of the utility product, in this case, Bangor Gas and, ultimately, its customers.

[3] The Tennessee Zone 6 price is the price one would pay for gas taken off the Tennessee interstate system in New England.

Bangor Gas's filings raise two issues. First, are the use of an index price in the gas procurement contract and a fixed price in setting the CGA likely to produce results that send the proper price signals to the customers in Bangor Gas's territory for the summer 2003 CGA period? Second, did Bangor Gas's bid procedures give a fair opportunity to other, non-affiliated gas suppliers, and should we approve the Bangor Gas/SET contract amendment?

a. Contract Pricing

We have found in prior CGA proceedings that the use of the Tennessee Zone 6 price is both consistent with the terms of the contract for gas supply that Bangor Gas has entered into and – apart from the effects of market volatility -- a fair estimation of the expected gas prices given Bangor Gas's gas supply arrangement. Moreover, under stable market conditions, the Company's use of the most recent market prices in setting the seasonal CGA rate should allow for the best available price signal to customers under this pricing approach. Unfortunately, the recent trend toward greater gas market volatility now suggests that Bangor Gas should explore contractual, pricing, purchasing, or rate-setting mechanisms that will better track, stabilize and/or optimize its gas costs. For the upcoming summer period, we find use of the present system of start-of-season market futures price as an estimate of summer gas costs acceptable, in large part because the summer is typically a period of much less volatility and smaller usage. However, we agree with Bangor Gas that this pricing system requires further scrutiny given the demonstrated risk of large over- or under-collections in periods of high market volatility.

Because of the unanticipated high market prices that occurred during the 2002-2003 winter season, Bangor Gas has under-collected a substantial amount. Accruing large over- or under-collections leads to rate shock and price signal effect, on customers in the next like season. [4]

In his testimony, Joe Cote recognized the need for Bangor Gas to consider whether a different method of pricing, rate-setting, or gas procurement may

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[4] In the past, we have approved mechanisms for LDCs with reconciling gas cost adjustment clauses to keep the size of over- or under-collections within a certain percentage range of total gas costs. See *Northern Utilities, Inc. Proposed Cost of Gas Adjustment for the Summer Period May 1, 1998 through October 31, 1998,* Docket No. 98-118 (April 30, 1998) at 2, citing *Northern Utilities, Inc.,* Docket No. 96-079, Order Approving Stipulation (April 26, 1996) at Stipulation paragraphs 7a and 7b (establishes that at any time prior to 75 days from the end of the current CGA period when Company projects a 7% or greater under- or over-collection of total gas costs, Company will file for mid-course correction.)

In July 2002, Bangor Gas proposed, and we thereafter approved, a streamlined mid-course adjustment process that adjusts the CGA season rate to reflect futures prices mid-way through the season.

be necessary to avoid incurring substantial over- or under-collections. The size of the past winter's under-collection prompted Bangor Gas to propose that a surcharge be added to the summer 2003 period rates to smooth recovery over a longer period of time. We discuss this issue below in Section IV(2).

b. Bid Procedure and Contract Amendment

The bid procedures were outlined by Bangor Gas in its initial filing and listed more than 20 registered Maine or regional natural gas suppliers that Bangor Gas invited to bid on its summer 2003 gas supply contract. As a start-up utility, Bangor Gas's supply needs are neither large nor predictable. We hope that with increasing load size Bangor Gas will attract more bidders for its gas supply needs.

Based on Staff's *in camera* review of information regarding Bangor Gas's bidding and selection process, we conclude that Bangor Gas's bid procedure for this period was fair and its selection of SET is reasonable. We would expect the Company to be as diligent in its ongoing searches for gas supply in future periods.

Upon Staff's review of the contract and *in camera* discussions on how purchases were made or could be made under the contract, we note that there are restrictions that take effect with the new summer contract extension. These restrictions require minimum volume nominations for certain pricing options. Given its small load, these provisions limit Bangor Gas's opportunity to select certain pricing options in certain months, constraining the Company in its efforts to reduce the cost of gas to its customers in volatile market conditions. While we find this limitation less important for the summer period when use is typically low and prices more stable, we emphasize that it is important that Bangor Gas negotiate to eliminate or reduce such contract restrictions or to establish new parameters that will provide the lowest possible price to its customers for the upcoming winter period. In addition, when evaluating bids received in the future, Bangor Gas should evaluate the effect of any purchase restrictions when selecting a bidder.

We find reasonable and thus approve the amendment to Bangor Gas's contract with SET, filed on April 10, 2003 pursuant to 35-A M.R.S.A. 707, to allow Bangor Gas to purchase its summer 2003 gas supply from its affiliate.

2. Winter 2002-2003 Under-Collection

Because of the large size of the 2002-2003 winter period under-collection, estimated at $292,000, Bangor Gas proposed its recovery over a 24-month period beginning with May 1, 2003. Typically, reconciliation for a prior winter season occurs in the succeeding winter period under the existing seasonal CGA mechanism. Because of its limited customer base, Bangor Gas expressed concern that charging its customers for the full under-collection in one winter period could create rate shock and would also limit Bangor Gas's competitiveness with other forms of heating fuel.

In its March 24th filing, Bangor Gas provided alternative recovery proposal analyses showing the rate effects of recovery over various time periods and seasons, including one, two or three winter periods and combined seasons over 24-36 months. Bangor Gas initially proposed recovery over 24 months as the best balance between mitigating rate shock and keeping the recovery as close to the period when the costs were actually incurred.

Three main concerns arise about these possible scenarios: (1) fairness to new customers of having to bear the cost of under-collections from previous periods; (2) the degree of inter-class subsidization due to different usage patterns in the winter and summer periods; and (3) potentially detrimental impacts of the recovery amount on Bangor Gas's ability to compete for new customers in the marketplace.

Spreading BGC's under-collection of approximately $292,000 over the next two winter periods would add approximately $0.0618 per therm to its CGA rates during that period, an increase of approximately 6.5% to 7.9% depending on rate class.[5] As with any reconciliation of past costs in the succeeding season, this increase will be paid both by customers who took service last winter and benefited from below cost rates during the 2002-2003 winter period, as well as by new customers who were not customers and therefore did not benefit from the lower than market rates that were in place. This is more troubling in a situation where the recovery of the past cost is significant and deferred over a longer period of time and when, as a startup utility, the utility can be expected to have a relatively large proportion of new to existing customers over the foreseeable future. On the whole, however, we see these as less compelling concerns than the rate shock and loss of competitive ability that would result from recovery in a single winter period.

Charging new customers for costs incurred prior to taking service is unavoidable when rate-setting mechanisms reconcile actual revenues and costs, as do cost of gas adjustments. Currently, any new customer with Bangor Gas pays a gas rate that includes a charge for past under-collections or the flow-back of over-recoveries. We recognize, however, that Bangor Gas is a start-up utility and therefore may be expected to have a disproportionately high level of new customers going forward. Nevertheless, if potential customers are made aware that the gas cost adjustment is part of the rate they must pay for gas service then fairness is less of a concern. We have previously addressed this concern by requiring Bangor Gas to add a statement to its rate schedule that informs customers that prior period over or under collections will be included in rates. See *Bangor Gas Company, LLC, Proposed Cost of Gas Factor, Order,* Docket No. 2000-697 (October 24, 2000) at 5.

We remain concerned that new customers, when they agree to take service, should be fully informed about the rates they will pay. A simple reference to gas futures prices and the general provision of reconciliation adjustments does not

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[5] This does not include any additional over or under-collection of CGA costs that might accrue during the next two winter seasons.

convey that the past gas cost adjustment is expected to increase rates for the upcoming winters 2003-2004 and 2004-2005 by a significant amount, according to current estimates. While we will not require BGC to make any specific disclosure statement, we do believe that it should fully inform customers of the existence and estimated magnitude of these deferred costs. It is important for a regulated entity to fully inform customers of how cost of service is determined and billed when they are deciding whether to take that service.

Another major question arises from Bangor Gas's proposal to charge winter period costs in summer period rates. CGA mechanisms for Maine gas utilities currently keep winter season costs and revenues separate from summer season costs and revenues. Doing so, in theory, helps ensure that revenue responsibility will better match customer usage patterns, reducing distortion. We must carefully consider whether good cause exists in this circumstance to vary from this policy.

Bangor Gas does not separate its customer classes into heating and non-heating customers so the Company cannot readily set rates that differentiate customers with lower use year-round and those with higher winter use (typically heating load). Because of this, and because the rate difference between winter-only recovery and Bangor Gas's 24-month proposal is manageable, both the Advisory Staff and the OPA concluded that recovery of the 2002-2003 winter under-collection over two winter periods is preferable. Bangor Gas also has agreed to the two-winter recovery option.

It should be noted that while the parties have agreed in principal that Bangor Gas will be able to recover the Winter 2002-2003 under-collection over two periods beginning with the Winter 2003-2004 period, the under-recovery amount incurred by Bangor Gas is subject to further analysis. Also, the final under-collection amount, to the extent it is found to be prudently incurred, will be included in the Winter 2003-2004 CGA filing.[6]

[6] We have addressed today the issue of possible recovery during the Summer 2003 period of portions of sizeable LDC Winter 2002-2003 cost of gas revenue under-collections in both Docket 2003-104, *Northern Utilities, Inc. Proposed Cost of Gas Factor for May 2003 - October 2003* and Docket No. 2003-111, *Bangor Gas, LLC, Proposed Cost of Gas Adjustment*. We have come to somewhat different conclusions regarding what an appropriate recovery period is in each of these cases, as did the parties who arrived at the recommendations contained in the Proposed Order in each case. We allow Northern to collect a portion of its 2002-2003 Winter period under-collection during the Summer 2003 period because it has distinct customer classes for high and low winter use customers. By applying the recovery responsibility proportionally, any subsidization between low and high winter usage customers is reduced. On the other hand, we approve recovery for Bangor Gas's Winter 2002-2003 period under-collection over two winter periods beginning in November 2003 because Bangor Gas does not have separate rate classes that allow allocation of cost responsibility consistent with seasonal usage. We feel it is better policy to avoid

3. Changes to Cost of Gas Recovery

The results of last winter have indicated that Bangor Gas's current gas purchasing strategy or its use of a traditional cost of gas adjustment may not be in the best interest of its ratepayers especially given current gas market volatility and its relatively small customer base. In particular, Bangor Gas appears to have limited options to reduce the effect of market volatility and, as a result, the balance of its under- (over-) collection account fluctuates with the market conditions. Specifically, as gas market prices rise above the futures price used to set its seasonal CGA, Bangor Gas will under-collect and as those prices decrease, it will over-collect. Implementing mid-course corrections, while reducing the under-collection somewhat, does not adequately mitigate the substantial accrual of Bangor Gas's under- (over-) collection balance during volatile market conditions. In its March 24th filing, Bangor Gas indicated that it is considering several different strategies that would greatly reduce the likelihood of the reoccurrence of large under-collections or over-collections in its CGA.

We direct Bangor Gas to continue with this review. It should also consider possible changes to its gas supply contract that would allow it more flexibility in its purchasing. We direct Bangor Gas to report back to us by May 7, 2003 on the status of this review and provide a date on which it will file its proposal. In order to get the full benefits of any proposed change, Bangor Gas should strive to implement such changes in time to benefit the Winter 2003-3004 period and therefore, should propose its changes to allow a reasonable amount of time to process any proposed tariff changes.

V. CONCLUSION

We approve Bangor Gas's proposal to use its affiliate, SET, to provide the necessary gas supplies for this Summer 2003 period. Bangor Gas's use of futures prices plus a transportation adder from an index that is consistent with the index on which its gas supply contract is based is reasonable for the upcoming summer period. The inclusion of the costs outlined above is reasonable, as is the proposed amendment to the SET contract for the Summer 2003 period.

However, because market volatility threatens the ongoing viability of the current gas purchasing and pricing mechanisms, Bangor Gas should fully explore alternative gas supply purchasing or pricing mechanisms for implementation to benefit the next winter period.

We do not allow Bangor Gas to collect a portion of the winter 2002-2003 period under-collection in its Summer 2003 period rates. We acknowledge that the parties have agreed, subject to the review of any additional information, to recommend that we

creating a circumstance in which lower use customers would pay more of the under-collection than their usage pattern would support.

allow Bangor Gas to recover the Winter 2002-2003 under-collection over the next two winter periods.

Accordingly, we

O R D E R

1. That Bangor Gas's proposed revised Cost of Gas Adjustment rate of $.579 per therm shall take effect for gas consumed on or after May 1, 2003;

2. That Bangor Gas's proposed revised past gas cost adjustment of $0.014 per therm shall take effect for gas consumed on or after May 1, 2003;

3. That Bangor Gas's proposed Past Gas Cost Surcharge of $0.047 per therm is not allowed and shall not take effect;

4. That Bangor Gas's Twelfth Revised Sheet Nos. 48 and 49 constituting its Cost of Gas Adjustment for the period May 1, 2003 through October 31, 2003, filed on April 15, 2003, are approved;

5. That the contract amendment between Bangor Gas and Sempra Energy Trading Corporation is approved;

6. That Bangor Gas shall report to us the status of its review of solutions to moderate the accrual of large past gas cost account balances by May 7, 2003 and indicate the date it will make any proposed changes; and

7. That Bangor Gas shall notify potential customers of the intention to include the recovery of the Winter 2002-2003 under-collection over a two-winter period as discussed in the body of this order.

Dated at Augusta, Maine, this 29th day of April, 2003.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent
Diamond

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within **21 days** of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.